
INDIAN BANKING: STRATEGIES FOR NON-PERFORMING LOAN MANAGEMENT

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ABSTRACT

The best indicator for the health of the banking industry in a country is its level of Non performing assets (NPAs). The problem of non-performing assets has shaken the entire Indian banking sector. The resolution of Non-Performing Assets and their recovery process relies completely on accurate credit evaluation and recovery system practice. Banks will tend to extend increased loans during periods of economic growth combined with liquidity imbalances. Adverse selection, and potential dangers of stock accumulation emerge from Competitive Unfair Lending Practices that degrade asset quality leading to concern about their selection process. High NPAs are one of the major concerns for banks in India. When an asset becomes NPAs the recovery wing states its operations. There are many recovery channels through which the banks recover NPAs. Performance of various recovery channels of NPAs in the Indian banking system is not found to be satisfactory. The Paper analyse the recovery mechanism of NPAs with its three important wing i.e. recovery through Lok Adalat, Debt Recovery Tribunals (DRTs) and Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act (SARFAESI Act) and its impact on NPA.

Introduction

Non-Performing Assets (NPAs) are one of the most important indicators of the health of the banking sector in any country. In India, the problem of NPAs has had a serious impact on the stability and profitability of banks, shaking the entire financial system and affecting economic growth. When banks accumulate too many bad loans, it reduces their profits, weakens their ability to lend to new borrowers, and can even cause people to lose trust in the banking system. This situation often arises from poor credit evaluation, unfair lending practices, and periods of economic boom when banks give out more loans than they should, sometimes to risky borrowers who are more likely to default.

The process of resolving these bad loans depends on how well banks assess the risk of lending and how effective their recovery systems are. High levels of NPAs force banks to focus on recovering their money through different channels, such as, Debt Recovery Tribunals (DRTs), and the SARFAESI Act. However, the performance of these recovery channels has not always been satisfactory, often due to slow processes and legal challenges. As a result, banks face greater financial stress, which can limit credit availability, slow down economic activity, and even lead to job losses. Recent regulatory reforms and new rules from the Reserve Bank of India (RBI) aim to strengthen the recovery process and improve the overall health of the banking sector. This paper analyzes the effectiveness of major NPA recovery mechanisms in India and examines their impact on the banking system and the wider economy.

Legal Frameworks for the recovery and resolution of Non- Performing Loans.

Sec.2 (o) of SARFAESI Act, 2001¹ defines non-performing asset as an asset or account of a borrower which has been classified by a bank or financial institution as substandard, doubtful or loss asset.

India has several laws and systems to help banks recover and resolve non-performing loans (NPAs). The main legal frameworks are the SARFAESI Act, the Insolvency and Bankruptcy Code (IBC), Debt Recovery Tribunals (DRTs), and Lok Adalats. These systems allow banks to take action against borrowers who do not repay loans, either by selling their assets, taking them to special courts, or encouraging settlements.

¹ Section 2(o) SARFAESI Act, 2001.

The effectiveness of these frameworks varies. The IBC has the highest recovery rate, usually between 30% and 50% of the loan amount, though this dropped to about 20–23% during the COVID-19 pandemic years. The SARFAESI Act allows banks to sell off a borrower's assets and usually recovers about 15–25% of the money owed. DRTs and Lok Adalats handle many cases but recover much less—DRTs often recover less than 10%, and Lok Adalats recover only about 6% or less each year.²³

Thanks to these efforts, the total amount of bad loans in Indian banks has dropped sharply in recent years. The gross NPA ratio was 11.18% in March 2018 but fell to 2.42% by December 2024⁴. Experts expect this number to go down further to about 2.4% by March 2025. However, challenges remain, such as slow legal processes and borrowers using delays to avoid repayment, which can make recovery slow—sometimes taking over 400 days to resolve a case.

In summary, while India's legal frameworks have helped reduce the number of bad loans and improved recoveries, the process is still slow and the amount recovered is often much less than the total owed. The IBC and SARFAESI Act are the most effective tools, but there is still a need for faster and more efficient systems to handle NPAs.

Role and Impact of the Corporate Debt Restructuring (CDR) Scheme in Effective Debt Management.

The Corporate Debt Restructuring (CDR) Scheme was introduced by the Reserve Bank of India (RBI) in 2001 to act as a solution to a company in organizing its outstanding debts. It was meant to act as a tool for corporates to deal with financial difficulties 'because of factors out of their control and due to internal reasons

The Corporate Debt Restructuring (CDR) scheme has played an important role in helping Indian companies manage their debts, especially when they have trouble repaying large loans. Introduced in 2001, CDR was designed to help companies avoid bankruptcy by allowing them to reorganize their debt with the agreement of most of their lenders. This means companies

² Reserve Bank of India. Year wise Recovery of NPAs of Scheduled Commercial Banks through Various Channels like Lok Adalats, Debt Recovery Tribunals (DRTs) and SARFAESI Act. Dataful. <https://dataful.in/datasets/17774>

³ Surojit Dey, Recovery Mechanisms of Non-Performing Assets in Indian Commercial Banks: An Empirical Study, NSOU-OPEN JOURNAL, Vol.1 No.2 (July 2018)

⁴ Hitesh Vyas, Bad loans decline: Banks' gross NPA ratio declines to 13-year low of 2.5% at September end, says RBI report, The Indian Express https://indianexpress.com/article/business/bad-loans-banks-gross-npa-ratio-low-end-september-rbi-report-9745690/#google_vignette.

could get more time to pay, lower interest rates, or even convert some debt into shares, instead of being forced into legal battles or liquidation.

The main goal of CDR was to provide a quick and transparent way for companies that are still viable (can survive in the long run) to restructure their debts and keep running, which also helps banks and other lenders recover more of their money. For a company to use CDR, it needed to have loans from more than one bank, with a total debt of at least ₹10 crore (100 million rupees), and at least 75% of the lenders (by value) had to agree to the restructuring plan.

In terms of numbers, between April 2012 and March 2014, Indian banks restructured over \$40 billion (about ₹2.4 lakh crore) of corporate loans through the CDR forum, which was more than all previous years combined.⁵ By 2014, the total amount of debt referred to CDR was about \$80 billion (around ₹4.8 lakh crore).⁶ Market estimates suggest that about 70–80% of the companies that went through CDR were able to meet their new payment terms, and about 40% of these companies were successfully revived and continued their operations.

However, not all CDR cases were successful. Some companies failed to recover even after restructuring, leading to losses for banks and eventual sale of these debts to asset reconstruction companies. Despite these challenges, CDR helped many companies avoid bankruptcy and gave banks a better chance of recovering their loans compared to long legal battles.

In summary, the CDR scheme was significant because it offered a way for financially troubled companies to survive and for banks to recover more money, with a large portion of restructured loans (70–80%) meeting their new terms and about 40% of companies being revived.

Impact of the Insolvency and Bankruptcy Code (IBC), 2016 on the Resolution of Non-Performing Assets (NPAs) Compared to Other Recovery Mechanisms in India.

The Insolvency and Bankruptcy Code (IBC), 2016, has made a big difference in how India deals with Non-Performing Assets (NPAs), especially when compared to older recovery methods like the SARFAESI Act and Debt Recovery Tribunals (DRTs). Before the IBC,

⁵ Anant Khandelwal, The Phenomenon of Corporate Debt Restructuring in India: How Far Can It Go To Prevent Insolvency? https://www.r3.org.uk/downloads/managed/RT_award_winners_papes/2014-Richard-Turton-Paper.pdf

⁶ Gautam Jagannathan, Aggregate Debt Under CDR Mechanisms at An All-Time High; 19 Fresh Cases During Q2 2015, <https://premium.capitalmind.in/2015/01/aggregate-debt-under-cdr-mechanisms-at-an-all-time-high-19-fresh-cases-during-q2-2015/>.

resolving bad loans was slow and often took several years, which made it hard for banks to recover their money and led to a buildup of NPAs in the financial system. The IBC changed this by introducing a strict timeline—usually 180 to 270 days—for resolving insolvency cases, making the process much faster and more efficient.

One of the most important impacts of the IBC is the much higher recovery rate for banks and lenders. According to the Economic Survey 2020, the average recovery rate under the IBC is about 42.5%, which is much better than the 14.5% recovery rate under the SARFAESI Act.⁷

Some high-profile cases, like Bhushan Steel and Essar Steel, saw even higher recoveries—63.5% and 84.89% respectively—showing that the IBC can help banks get back a significant portion of their money in large cases.⁸ In contrast, DRTs and Lok Adalats usually recover less than 10% of the dues, and the process is much slower.

The IBC also gives more power to creditors, allowing them to take control of the resolution process and make decisions together. This creditor-driven approach means banks are no longer stuck waiting for long court processes or forced to accept poor settlements. The IBC encourages market-driven solutions, such as selling the company to new owners, which can save jobs and keep businesses running.

Another major benefit is that the IBC acts as a strong warning to borrowers, because if they default, they risk losing control of their company. This has encouraged better repayment behavior and reduced the number of willful defaulters. Overall, the IBC has helped clean up bank balance sheets, improved the health of the financial sector, and made it easier for banks to lend money again.

In summary, the IBC is much more effective than earlier recovery mechanisms. It is faster, helps banks recover more money, gives creditors more control, and encourages better behavior from borrowers. These improvements have made the IBC a key tool in tackling NPAs in India.

⁷ BFSI from the Economic times <https://bfsi.economictimes.indiatimes.com/news/banking/ibc-recovered-42-5-of-total-bad-loans-filed-with-nclat-economic-survey/73803095>.

⁸ CA CS Funnisha Garg, Reforming corporate distress resolution in India: A financial and legal analysis of the insolvency and bankruptcy code (IBC), 2016, International Journal of Financial Management and Economics 2025; 8(1): 341-345.

Conclusion

The effectiveness of legal frameworks in managing non-performing loans (NPAs) in India is closely linked to their ability to balance fast recovery for banks with fair treatment of borrowers, which in turn impacts financial stability. The Insolvency and Bankruptcy Code (IBC), 2016, is a prime example of this balance. The IBC introduced a time-bound and structured process—mandating resolution within 180 to 270 days—which significantly sped up NPA resolution compared to earlier mechanisms like the SARFAESI Act and Debt Recovery Tribunals that were often slow and fragmented. This efficiency not only improved recovery rates for banks (with average recoveries of about 43% under the IBC, compared to lower rates under previous laws), but also empowered creditors to take a leading role in the process, ensuring their interests were protected while still allowing borrowers a fair chance to restructure or revive their businesses.⁹

At the same time, the IBC and similar frameworks are designed to ensure that borrowers are treated fairly. The process is transparent and market-driven, with opportunities for competitive bidding and restructuring, which can help viable businesses survive and protect jobs. The threat of losing control of the company acts as a deterrent against willful default, promoting better credit discipline. By balancing these interests, the IBC has contributed to a healthier banking sector and greater financial stability in India, as seen in the sharp drop in gross NPA ratios in recent years. Thus, the hypothesis is supported: the effectiveness of NPA management frameworks in India does depend on their ability to combine speedy recoveries for banks with fairness for borrowers, ultimately strengthening the country's financial system.

⁹ Rohit Jain, *Economic Survey 2021: Recoveries Under IBC Highest Among All Debt Recovery Methods*, NDTV Profit, <https://www.ndtvprofit.com/law-and-policy/economic-survey-2021-recoveries-under-ibc-highest-among-all-debt-recovery-methods>

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